

Alcoholic Beverage Shipping and Distribution Interim Committee

Study Assignment:

A comprehensive review of alcoholic beverage shipping and distribution regulation in South Dakota. The study included:

- (1) The three-tier system of alcohol distribution in the state to determine if the current system is necessary and appropriate in today's society;
- (2) The intrastate and interstate shipping of wine, beer, and spirits, including how the shipping would affect the three-tiered system including equality of taxation, enforcement, equality for retailers - both in-state and out-of-state, social issues, and permits and licenses; and
- (3) The possibility of creating a direct-to-consumer winery shipping law.

Summary of Interim:

The committee began its examination of alcoholic beverage shipping and distribution laws in June. After an initial review of the scope of the committee, Heather Morton from the National Conference of State Legislatures reported on systems used around the country for alcohol distribution and shipment. Ms. Morton reported that each state has a three-tiered distribution system, consisting of 1) manufacturers and producers, 2) distributors and wholesalers, and 3) retailers, including stores, bars, and restaurants. This is meant to provide a system of checks and balances to ensure the quality of the alcoholic beverages and simplify the collection of taxes. Each state is either a license or a control state. A control state operates the distribution tier and may participate in the retail tier through state-run liquor stores. A license state does not participate in distributing or selling alcoholic beverages, it merely issues licenses to do so. South Dakota is a license state.

Jason Evans from the Department of Revenue made a presentation regarding the regulation and taxation of alcoholic beverages in the state. Mr. Evans reported that under the three-tier system, only manufacturers are allowed to sell alcohol to wholesalers, only wholesalers can sell to retailers, and only the retailers can sell alcohol to the end consumer, which maximizes control over the industry and minimizes tax administration and enforcement. There are currently 60 alcohol taxpayers in the state, and 5,394 retail liquor/beer licensees. Mr. Evans explained that there are three exceptions to the three-tier system. The first exception was implemented in 1989 and applies to malt beverage manufacturers who produce 5,000 barrels or less and sell the product for on premise consumption only. There are 10 such licensees at this time and there is a \$500 annual license fee. The second exception was implemented in 1996 and allows farm wineries that produce up to 150,000 gallons annually to sell their product for either on-premise or off-premise consumption. Currently, there are 26 such licensees and the license costs \$100 annually. The third exception to the three-tier system is the artisan distillers. An artisan distiller can produce up to 50,000 gallons annually and can sell their product for either on-premise or off-premise consumption. The artisan distiller may sell to wholesalers and to end consumers but cannot sell directly to retailers. There are four such licensees and the

license costs \$500 annually. Mr. Evans reminded the committee that a change to the three-tier system would likely require more staffing for the Department.

Mr. Bob Riter, a registered lobbyist for the South Dakota Beer Distributor's Association, gave a summary of the history of alcohol sales, going back to prohibition. Mr. Riter pointed out that there were less than 50 brewers in the country in 1950, and now there are more than 2,400. Mr. Riter also briefly explained how the distribution territories worked with the consumers, in that retailers can only buy alcohol from a certain distributor, which has to sell to all retailers at the same price. A retailer cannot buy from a different distributor, pursuant to an agreement with the manufacturers.

Jeremiah Murphy, a registered lobbyist for Republic National Distributing Company, and Tim Dougherty, a registered lobbyist from the Licensed Beverage Dealers of South Dakota, both testified that their clients would not oppose wine shipment provided the taxation were equal between in-state and out-of-state wineries and distributors. Jim Hood, a registered lobbyist for the Wine Institute, and Diana Miller, a registered lobbyist for South Dakota for Better Wine Laws, both testified that their clients supported direct shipment of wine, promoting the economic benefits to the state from wine shipped to residents.

At the second meeting, Roxanne Hammond, Legislative Attorney, presented to the committee on the alcohol-related legislation from 2010-2014. Ms. Hammond reported that since 2010, 63 alcohol-related bills have been introduced, and 24 of those bills passed. The bills passed include a law creating a combination license for the sale of both malt beverages and wine, a law allowing alcoholic beverage licensees to charge a corkage fee, and a law to allow wineries to pay taxes quarterly. A handful of bills that would have allowed direct shipment of wine were introduced, but failed.

Jeremiah Murphy and Tim Dougherty presented draft legislation, as requested during the first meeting. The template for the draft legislation was the wine shipment bill used in 2014 (SB 114), with some additions brought by their clients. Changes included defining a "wine carrier"; requiring wineries to choose to register a wine label for either direct shipment or retail, but not both; the increase of the wine shipment registration fee from \$150 to \$250; as well as administrative changes to the reporting to the Department of Revenue and penalties. Diana Miller spoke against the proposed bill, stating that her client does not support the registration of wine carriers, and the increase of the fee is disproportionate compared to surrounding states.

Paul Lewis, owner of Black Hills Dakota Distillery, pointed out several discrepancies between artisan distilleries and farm wineries, including a \$500 license fee for distilleries (\$100 for farm wineries), and the inability of distilleries to sell to distributors and retailers like farm wineries. Mr. Lewis presented two proposed bills that would allow artisan distilleries many of the same rights as farm wineries. Bob Riter spoke in favor of giving the same rights to craft brewers as well. The committee also heard public testimony in favor and opposition to direct wine shipment.

At the third meeting, three pieces of legislation were presented for committee consideration. The first draft was based on the draft presented at the prior meeting by Tim

Dougherty and Jeremiah Murphy. Some changes to the legislation included the addition of a 1% direct shipment tax applied to the retail price of all wine shipped into the state, in lieu of the 2% wholesale tax applied to other alcohol sold through wholesalers in South Dakota. The bill also included a section requiring the Department of Revenue to keep a list of registered wine labels available to the public, and a section prohibiting wine to be sold below the wholesale cost.

Jeff Carol, Vice President of Compliance, ShipCompliant, of Boulder, CO, testified via telephone. Mr. Carol said that his company runs shipment compliance services for wineries that are allowed direct shipment to other states. ShipCompliant is a software program that tracks state wine shipment laws and ensures that businesses that use their services are compliant with each state's wine laws.

Dianna Miller spoke in favor of the first piece of legislation. Jeremiah Murphy presented a document entitled "Level Playing Field". Mr. Murphy said that making the list of wines delivered into South Dakota available will help South Dakota's wholesalers in knowing what wines are being sold through direct shipment. Tim Dougherty testified in favor of registering wine carriers. Jason Evans from the Department of Revenue requested a delayed implementation date in order to allow the department to prepare for the new system. The committee agreed that the current legislation was not up to standard and should be revised and resubmitted at the next meeting.

During the final meeting, the committee heard discussion on four bills. Roxanne Hammond from the LRC went through the changes made to the direct wine shipment bill draft from the previous meeting. Tim Dougherty, Dianna Miller, Jim Hood, Don Roesler, Bob Riter, Jeremiah Murphy, and Yvonne Taylor all spoke in favor of, or acceptance of, the draft proposal. Jason Evans said the department does not support nor oppose this draft. Tim Dougherty suggested several amendments, and three amendments were integrated into the draft. The suggestions to raise the fee to \$250 and add local mark ups were rejected. The committee discussed using bottles versus weight to track the amount of wine shipped into the state, ultimately deciding to use weight.

The committee then discussed the second draft legislation, a bill allowing artisan distillers to sell their products directly to retailers and wholesalers. Bob Riter testified that in-state businesses must be given the same rights as out-of-state businesses, and carving a specific niche may cause problems later. Paul Lewis and Jeremiah Murphy testified in favor of the draft.

The committee then heard testimony on the third draft, creating an appropriation to the Department of Revenue to aid in the electronic submission of reports and taxes related to direct shipment of wine and alcoholic beverages.

Finally, the committee heard testimony on the fourth draft, a bill to abolish the wholesaler tax and transfer costs into the occupational tax. Jeremiah Murphy and Tim Dougherty both testified in favor of the bill.

Listing of Legislation Adopted by the Committee

1. An Act to establish a wine direct shipment license and wine carrier license to enable the direct shipments of certain wine in South Dakota.

This bill provides for the direct shipment of wine to consumers, as well as sets up infrastructure for the payment of taxes for the wine shippers, and creates penalties for failure to register prior to wine shipment.

2. An Act to allow for the direct sale of distilled spirits from artisan distillers to retailers and wholesalers.

This bill allows artisan distillers to sell their distilled spirits directly to retailers and wholesalers, up to a certain gallon amount.

3. An Act make an appropriation to fund the Department of Revenue to aid in the electronic submission of reports and taxes related to alcoholic beverages and to declare an emergency.

This draft allocates \$100,000 to the department to be used to create infrastructure to allow out-of-state wineries and other alcohol taxpayers to submit their taxes electronically.

4. An Act to abolish the alcohol wholesaler tax and transfer costs to the occupational tax on certain alcoholic beverages.

This bill eliminates the 2% wholesaler tax and increases the amount of the taxes paid per gallon under the occupational tax.

Summary of Meeting Date and Places

The Alcoholic Beverage Shipping and Distribution Committee met in Pierre on June 10th, July 7th, September 2nd, and October 20th, 2014.

Listing of Committee Members

Committee members were: Representative Roger Solum, Chair; Senator Corey Brown, Vice Chair; Senators Jim Bradford, Ryan Maher, and Craig Tieszen; and Representatives Brock Greenfield, Troy Heinert, and Timothy Johns.

Listing of Staff

Staff members were: Roxanne Hammond, Legislative Attorney, Fred Baatz, Senior Research Analyst, Doug Decker, Code Counsel, Aaron Olson, Fiscal Analyst, and Cindy Tryon, Legislative Secretary.